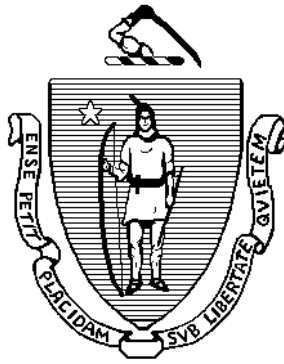


# *Financial Section*



Independent Auditor's Report  
Combined Financial Statements - Statutory Basis  
Combining and Individual Fund Financial Statements - Statutory Basis

**Independent Auditors' Report**

Mr. William Kilmartin, Comptroller  
The Commonwealth of Massachusetts

We have audited the accompanying combined financial statements - statutory basis of the Commonwealth of Massachusetts as of June 30, 1998, and for the year then ended, listed in the foregoing table of contents. These combined financial statements - statutory basis are the responsibility of the management of the Commonwealth of Massachusetts. Our responsibility is to express an opinion on these combined financial statements - statutory basis based on our audit. We did not audit the financial statements of the Pension Reserves Investment Trust, which is the investment vehicle of the Commonwealth of Massachusetts' Pension Trust Funds, the financial statements of which reflect 83 percent and 70 percent, respectively, of the total assets and total revenues of the Fiduciary Fund Type. Those financial statements were audited by another auditor whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Pension Reserves Investment Trust, is based solely on the report of the other auditor.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements statutory basis are free of material misstatement. The financial statements of the Pension Reserves Investment Trust were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements - statutory basis. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement - statutory basis presentation. We believe that our audit and the report of the other auditor provide a reasonable basis for our opinion.

As described in Note 2 to the combined financial statements - statutory basis, the Commonwealth of Massachusetts prepares its combined financial statements - statutory basis on a prescribed basis of accounting that demonstrates compliance with General Laws and budgetary principles and funds of the Commonwealth of Massachusetts which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, based upon our audit and the reports of the other auditors, such combined financial statements - statutory basis referred to above present fairly, in all material respects, the financial position of the Commonwealth of Massachusetts as of June 30, 1998, and the results of its operations for the year then ended, on the basis of accounting described in Note 2.

Our audit was conducted for the purpose of forming an opinion on the combined financial statements -statutory basis taken as a whole. The combining and individual fund statements statutory basis, and supplemental information listed in the table of contents, are presented for the purpose of additional analysis and are not a required part of the combined financial statements statutory basis of the Commonwealth of Massachusetts. These statements, schedules and supplemental information are also the responsibility of the management of the Commonwealth of Massachusetts. Such additional information has been subjected to the auditing procedures applied in the audit of the combined financial statements - statutory basis and, based on our audit and the reports of other auditors, in our opinion, is fairly stated in all material respects in relation to the combined financial statements - statutory basis taken as a whole.

We did not audit the data included in the introductory and statistical sections of this report and accordingly, we express no opinion on such data.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 1998 on our consideration of the Commonwealth of Massachusetts internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

This report is intended solely for the use of elected and appointed officials of the Commonwealth of Massachusetts and should not be used for any other purposes. This report is a matter of public record and its distribution is not limited.

October 27, 1998

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# *Combined Financial Statements -Statutory Basis*

**All Fund Types And Account Groups**  
**Combined Balance Sheet - Statutory Basis**

June 30, 1998  
(Amounts in thousands)

	Governmental Fund Types			Fiduciary Fund Types
	Budgeted	Non-Budgeted Special Revenue	Capital Projects	Trust and Agency
<b>ASSETS AND OTHER DEBITS</b>				
Cash and short-term investments.....	\$ 4,003,541	\$ 562,881	\$ 420,217	\$ 1,480,896
Cash on deposit with U.S. Treasury.....	-	-	-	1,699,693
Cash with fiscal agent.....	26,059	11,572	-	-
Investments.....	-	-	-	23,395,600
Advances to related entity.....	232,762	-	-	-
Assets held in trust.....	-	-	-	1,866,078
Receivables, net of allowance for uncollectibles:				
Taxes.....	5,108	732	-	-
Due from federal government.....	171,943	287,905	4,475	-
Other receivables.....	19,061	29,282	-	482,658
Due from cities and towns.....	150,028	-	-	-
Due from other funds.....	6,130	-	102,786	-
Fixed assets:				
Land.....	-	-	-	-
Buildings.....	-	-	-	-
Machinery and equipment.....	-	-	-	-
Construction in progress.....	-	-	-	-
Amount available for retirement of long-term obligations.....	-	-	-	-
Amount to be provided for retirement of long-term obligations....	-	-	-	-
Total assets and other debits.....	<u>\$ 4,614,632</u>	<u>\$ 892,372</u>	<u>\$ 527,478</u>	<u>\$ 28,924,925</u>
<b>LIABILITIES, FUND EQUITY AND OTHER CREDITS</b>				
Liabilities:				
Deficiency in cash and short-term investments.....	\$ 1,781,454	\$ 26,573	\$ 544,903	\$ -
Accounts payable.....	612,316	243,921	331,101	933,732
Accrued payroll.....	24,616	1,145	510	79
Other liabilities.....	-	-	-	2,837,718
Due to cities and towns.....	-	-	-	22,673
Due to other funds.....	4,120	103,124	-	1,672
Capital leases.....	-	-	-	-
Bonds and notes payable.....	-	-	-	-
Total liabilities.....	<u>2,422,506</u>	<u>374,763</u>	<u>876,514</u>	<u>3,795,874</u>
Fund equity and other credits:				
Investment in general fixed assets.....	-	-	-	-
Fund balances (deficit):				
Reserved for:				
Continuing appropriations.....	260,289	-	-	-
Commonwealth stabilization.....	1,159,588	-	-	-
Tax reduction.....	367,663	-	-	-
Debt service.....	26,059	27,240	-	-
Employees' pension benefits.....	-	-	-	23,221,308
Unemployment benefits.....	-	-	-	1,699,693
Capital projects.....	-	-	269,478	-
Unreserved:				
Designated for specific purpose.....	-	490,369	-	208,050
Undesignated.....	378,527	-	(618,514)	-
Total fund equity (deficit) and other credits.....	<u>2,192,126</u>	<u>517,609</u>	<u>(349,036)</u>	<u>25,129,051</u>
Total liabilities, fund equity and other credits.....	<u>\$ 4,614,632</u>	<u>\$ 892,372</u>	<u>\$ 527,478</u>	<u>\$ 28,924,925</u>

See notes to combined financial statements - statutory basis.

Account Groups		Totals (Memorandum Only)	
General Fixed Assets	General Long-term Obligations	1998	1997
\$ -	\$ -	\$ 6,467,535	\$ 4,030,484
-	-	1,699,693	1,222,725
-	-	37,631	24,823
-	-	23,395,600	19,528,772
-	-	232,762	229,063
-	-	1,866,078	1,708,422
-	-	5,840	7,435
-	-	464,323	674,779
-	-	531,001	273,451
-	-	150,028	141,580
-	-	108,916	3,657
589,512	-	589,512	564,854
4,005,976	-	4,005,976	3,700,765
1,187,321	-	1,187,321	1,177,749
156,227	-	156,227	121,370
-	53,299	53,299	44,891
-	11,182,160	11,182,160	10,357,778
<u>\$ 5,939,036</u>	<u>\$ 11,235,459</u>	<u>\$ 52,133,902</u>	<u>\$ 43,812,598</u>
\$ -	\$ -	\$ 2,352,930	\$ 1,441,205
-	-	2,121,070	1,583,053
-	-	26,350	16,048
-	-	2,837,718	2,469,062
-	-	22,673	20,142
-	-	108,916	3,657
-	156,856	156,856	131,375
-	11,078,603	11,078,603	10,271,294
<u>-</u>	<u>11,235,459</u>	<u>18,705,116</u>	<u>15,935,836</u>
5,939,036	-	5,939,036	5,564,738
-	-	260,289	180,260
-	-	1,159,588	799,300
-	-	367,663	91,764
-	-	53,299	44,891
-	-	23,221,308	19,560,061
-	-	1,699,693	1,222,725
-	-	269,478	229,800
-	-	698,419	266,969
-	-	(239,987)	(83,746)
<u>5,939,036</u>	<u>-</u>	<u>33,428,786</u>	<u>27,876,762</u>
<u>\$ 5,939,036</u>	<u>\$ 11,235,459</u>	<u>\$ 52,133,902</u>	<u>\$ 43,812,598</u>

**All Governmental Fund Types And Expendable Trust Funds**  
**Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis**  
**Fiscal Year Ended June 30, 1998**  
**(Amounts in thousands)**

	Governmental Fund Types		
	Budgeted	Non-budgeted Special Revenue	Capital Projects
<b>REVENUES AND OTHER FINANCING SOURCES</b>			
Revenues:			
Taxes.....	\$ 14,026,256	\$ 11,631	\$ -
Assessments.....	255,134	261,650	-
Federal grants and reimbursements.....	3,361,181	1,482,709	785,241
Departmental.....	1,082,591	3,844,785	243
Payments from authorities.....	-	-	112,515
Miscellaneous.....	189,295	110,509	589
Total revenues.....	18,914,457	5,711,284	898,588
Other financing sources:			
Proceeds of general obligation bonds.....	-	-	766,953
Proceeds of grant anticipation notes.....	-	580,557	-
Proceeds of special obligation bonds.....	-	-	100,059
Proceeds of refunding bonds.....	-	-	861,793
Fringe benefit cost recovery.....	224,761	-	-
Lottery reimbursements.....	71,990	32,093	-
Lottery distributions.....	788,802	-	-
Transfer for MBTA contract assistance.....	129,176	-	-
Sewer rate relief.....	-	50,700	-
Caseload mitigation.....	10	-	-
Surplus transfer to capital projects.....	-	-	111,571
Transfer for capital projects funds.....	-	-	189,235
Operating transfers in.....	428,739	339,748	507,415
Collective bargaining reserve.....	75,068	-	-
Stabilization transfer.....	317,357	-	-
Transfer for tax reduction.....	454,264	-	-
State share of federal highway construction.....	-	-	550,672
Other sources.....	-	-	-
Total other financing sources.....	2,490,167	1,003,098	3,087,698
Total revenues and other financing sources.....	21,404,624	6,714,382	3,986,286
<b>EXPENDITURES AND OTHER FINANCING USES</b>			
Expenditures:			
Legislature.....	51,045	-	214
Judiciary.....	465,833	365	9,692
Inspector General.....	1,858	-	520
Governor and Lieutenant Governor.....	5,080	-	-
Secretary of the Commonwealth.....	22,333	725	5,716
Treasurer and Receiver-General.....	97,773	2,560,007	4,901
Auditor of the Commonwealth.....	12,953	-	2,276
Attorney General.....	25,383	4,851	4,386
Ethics Commission.....	1,279	-	25
District Attorney.....	66,139	2,062	871
Office of Campaign & Political Finance.....	764	-	-
Sheriff's Departments.....	40,405	108	-
Disabled Persons Protection Commission.....	1,516	11	51
Board of Library Commissioners.....	6,241	2,591	13,448
Comptroller.....	7,129	-	2,979
Administration and finance.....	1,072,737	64,753	313,078
Environmental affairs.....	197,964	22,399	146,528
Communities and development.....	135,636	217,879	80,014
Health and human services.....	3,681,018	1,106,905	33,326
Transportation and construction.....	795,525	6,745	1,988,965
Education.....	237,184	435,695	5,865
Higher education.....	861,840	4,833	26,583
Public safety.....	809,305	37,093	21,354
Economic development.....	28,800	7,945	977
Elder affairs.....	153,879	25,379	124

Fiduciary Fund Type	Totals (Memorandum Only)	
	1998	1997
Expendable Trust		
\$ 1,092,698	\$ 15,130,585	\$ 14,048,751
2,306	519,090	558,479
28,930	5,658,061	5,298,577
15,489	4,943,108	4,557,340
-	112,515	-
285,645	586,038	418,502
1,425,068	26,949,397	24,881,649
-	766,953	899,471
-	580,557	-
-	100,059	-
-	861,793	722,621
-	224,761	197,667
-	104,083	81,510
-	788,802	685,137
-	129,176	137,869
-	50,700	54,398
-	10	128,000
-	111,571	89,503
-	189,235	229,800
78,796	1,354,698	211,781
-	75,068	50,000
-	317,357	234,253
-	454,264	150,000
-	550,672	175,958
3,079	3,079	2,073
81,875	6,662,838	4,050,041
1,506,943	33,612,235	28,931,690
-	51,259	50,611
226	476,116	437,580
-	2,378	2,330
-	5,080	5,263
5	28,779	18,495
1,380	2,664,061	2,708,397
170	15,399	13,651
3,404	38,024	30,020
-	1,304	1,193
3,152	72,224	64,512
-	764	670
-	40,513	-
-	1,578	1,476
-	22,280	20,752
-	10,108	8,486
9,529	1,460,097	1,299,925
7,137	374,028	316,591
606	434,135	419,888
17,934	4,839,183	4,291,963
526	2,791,761	2,466,763
6,117	684,861	589,743
117	893,373	817,698
2,645	870,397	883,141
754	38,476	43,734
36	179,418	166,959



**All Governmental Fund Types And Expendable Trust Funds**  
**Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis**  
**Fiscal Year Ended June 30, 1998**  
**(Amounts in thousands)**

	Governmental Fund Types		
	Budgeted	Non-budgeted Special Revenue	Capital Projects
Expenditures (continued):			
Consumer affairs.....	36,914	1,383	1,329
Labor.....	47,977	165,612	197
Direct local aid.....	3,948,982	7,762	-
Medicaid.....	3,665,839	-	-
Pension.....	1,069,771	-	-
Debt service:			
Principal retirement.....	706,489	776	-
Interest and fiscal charges.....	506,874	450	-
Total expenditures.....	18,762,465	4,676,329	2,663,419
Other financing uses:			
Payments to refunded bond escrow agent.....	-	-	861,793
Fringe benefit cost assessment.....	93,082	41,736	17,899
Lottery operating reimbursements.....	-	104,083	-
Lottery distributions.....	-	788,802	-
Transfer for MBTA contract assistance.....	129,176	-	-
State share of federal highway construction.....	-	-	550,672
Operating transfers out.....	423,616	741,701	109,762
Sewer rate relief.....	50,700	-	-
Collective bargaining reserve.....	75,068	-	-
Caseload mitigation.....	10	-	-
Transfer for capital projects funds.....	189,235	-	-
Surplus transfer for capital projects.....	111,571	-	-
Stabilization transfer.....	317,357	-	-
Transfer for tax reduction.....	454,264	-	-
Total other financing uses.....	1,844,079	1,676,322	1,540,126
Total expenditures and other financing uses.....	20,606,544	6,352,651	4,203,545
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses.....	798,080	361,731	(217,259)
Fund balances (deficits) at beginning of year.....	1,394,046	155,878	(131,777)
Fund balances (deficits) at end of year.....	\$ 2,192,126	\$ 517,609	\$ (349,036)

See notes to combined financial statements - statutory basis.

Fiduciary Fund Type	Totals (Memorandum Only)	
Expendable Trust	1998	1997
6,402	46,028	44,094
790,171	1,003,957	1,030,796
-	3,956,744	3,564,653
-	3,665,839	3,455,531
-	1,069,771	1,069,184
-	707,265	752,669
-	507,324	525,617
850,311	26,952,524	25,102,385
-	861,793	722,621
3,086	155,803	124,989
-	104,083	81,510
-	788,802	685,137
-	129,176	137,869
-	550,672	175,958
79,619	1,354,698	211,781
-	50,700	54,398
-	75,068	50,000
-	10	128,000
-	189,235	229,800
-	111,571	89,503
-	317,357	234,253
-	454,264	150,000
82,705	5,143,232	3,075,819
933,016	32,095,756	28,178,204
573,927	1,516,479	753,486
1,327,981	2,746,128	1,992,642
\$ 1,901,908	\$ 4,262,607	\$ 2,746,128

## Budgeted Funds

### Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis - Budget and Actual

Fiscal Year Ended June 30, 1998  
(Amounts in thousands)

	Budget	Actual	Variance Favorable (Unfavorable)
<b>REVENUES AND OTHER FINANCING SOURCES</b>			
Revenues:			
Taxes.....	\$ 12,815,300	\$ 14,026,256	\$ 1,210,956
Assessments.....	-	255,134	255,134
Federal grants and reimbursements.....	3,287,200	3,361,181	73,981
Departmental.....	1,243,600	1,082,591	(161,009)
Miscellaneous.....	-	189,295	189,295
Total revenues.....	17,346,100	18,914,457	1,568,357
Other financing sources:			
Fringe benefit cost recovery.....	-	224,761	224,761
Lottery reimbursements.....	80,735	71,990	(8,745)
Lottery distributions.....	640,800	788,802	148,002
Transfer for MBTA contract assistance.....	-	129,176	129,176
Caseload mitigation.....	-	10	10
Operating transfers in.....	305,117	428,739	123,622
Collective bargaining reserve.....	-	75,068	75,068
Stabilization transfer.....	-	317,357	317,357
Transfer for tax reduction.....	-	454,264	454,264
Total other financing sources.....	1,026,652	2,490,167	1,463,515
Total revenues and other financing sources.....	18,372,752	21,404,624	3,031,872
<b>EXPENDITURES AND OTHER FINANCING USES</b>			
Expenditures:			
Legislature.....	72,647	51,045	21,602
Judiciary.....	497,910	465,833	32,077
Inspector General.....	1,871	1,858	13
Governor and Lieutenant Governor.....	6,295	5,080	1,215
Secretary of the Commonwealth.....	24,662	22,333	2,329
Treasurer and Receiver-General.....	108,574	97,773	10,801
Auditor of the Commonwealth.....	12,957	12,953	4
Attorney General.....	25,516	25,383	133
Ethics Commission.....	1,279	1,279	-
District Attorney.....	66,662	66,139	523
Office of Campaign & Political Finance.....	768	764	4
Sheriff's Departments.....	45,218	40,405	4,813
Disabled Persons Protection Commission.....	1,528	1,516	12
Board of Library Commissioners.....	6,277	6,241	36
Comptroller.....	7,136	7,129	7
Administration and finance.....	1,227,721	1,072,737	154,984
Environmental affairs.....	224,558	197,964	26,594
Communities and development.....	139,699	135,636	4,063
Health and human services.....	3,800,197	3,681,018	119,179
Transportation and construction.....	807,297	795,525	11,772
Education.....	240,912	237,184	3,728
Higher education.....	867,954	861,840	6,114
Public safety.....	824,077	809,305	14,772
Economic development.....	77,488	28,800	48,688
Elder affairs.....	155,169	153,879	1,290
Consumer affairs.....	38,298	36,914	1,384
Labor.....	52,554	47,977	4,577
Direct local aid.....	3,953,051	3,948,982	4,069
Medicaid.....	3,706,508	3,665,839	40,669
Pension.....	1,069,883	1,069,771	112
Debt service:			
Principal retirement.....	720,152	706,489	13,663
Interest and fiscal charges.....	519,060	506,874	12,186
Total expenditures.....	19,303,878	18,762,465	541,413
Other financing uses:			
Fringe benefit cost assessment.....	-	93,082	(93,082)
Transfer for MBTA contract assistance.....	131,450	129,176	2,274
Operating transfers out.....	423,616	423,616	-
Sewer rate relief.....	50,700	50,700	-
Collective bargaining reserve.....	75,068	75,068	-
Caseload mitigation.....	10	10	-
Transfer for capital projects funds.....	189,235	189,235	-
Surplus transfer for capital projects.....	-	111,571	(111,571)
Stabilization transfer.....	150,000	317,357	(167,357)
Transfer for tax reduction.....	454,264	454,264	-
Total other financing uses.....	1,474,343	1,844,079	(369,736)
Total expenditures and other financing uses.....	20,778,221	20,606,544	171,677
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses.....	(2,405,469)	798,080	3,203,549
Fund balances at beginning of year.....	1,394,046	1,394,046	-
Fund balances (deficits) at end of year.....	\$ (1,011,423)	\$ 2,192,126	\$ 3,203,549

See notes to combined financial statements - statutory basis.

## Nonexpendable Trust Fund

### Statement Of Revenues, Expenses And Changes In Fund Balances - Statutory Basis

Fiscal Year Ended June 30, 1998  
(Amounts in thousands)

	1998	1997
<b>REVENUES</b>		
Revenues:		
Investment earnings.....	\$ -	\$ -
Total revenues.....	-	-
<b>EXPENSES</b>		
Expenses:		
Treasurer and Receiver-General.....	-	-
Total expenses.....	-	-
Excess of revenues over expenses.....	-	-
Fund balances at beginning of year.....	5,835	5,835
Fund balances at end of year.....	\$ 5,835	\$ 5,835

See notes to combined financial statements - statutory basis.

## Pension Trust Funds

### Combined Statement of Changes in Net Assets Available for Pension Benefits - Statutory Basis

Fiscal Year Ended June 30, 1998  
(Amounts in thousands)

	1998	1997
Additions:		
Commonwealth contributions.....	\$ 939,089	\$ 899,048
Employees contributions.....	530,761	457,530
Total contributions.....	<u>1,469,850</u>	<u>1,356,578</u>
Net investment income:		
Net appreciation in fair value of investments.....	2,788,533	2,823,841
Interest.....	352,503	368,654
Dividends.....	256,430	158,922
Real estate operating income, net.....	71,824	54,525
Alternative investments.....	5,205	27,457
Other.....	<u>3,755</u>	<u>156</u>
Total investment income.....	3,478,250	3,433,555
Less: investment expense.....	<u>42,869</u>	<u>60,703</u>
Net investment income.....	<u>3,435,381</u>	<u>3,372,852</u>
Total additions.....	<u>4,905,231</u>	<u>4,729,430</u>
Deductions:		
Administration.....	35,973	3,688
Retirement benefits and refunds.....	<u>1,208,011</u>	<u>1,121,952</u>
Total deductions.....	<u>1,243,984</u>	<u>1,125,640</u>
Net increase .....	3,661,247	3,603,790
Net assets available for pension benefits at beginning of year (fund balances reserved for employees' pension benefits).....	<u>19,560,061</u>	<u>15,956,271</u>
Net assets available for pension benefits at end of year (fund balances reserved for employees' pension benefits).....	<u>\$ 23,221,308</u>	<u>\$ 19,560,061</u>

See notes to combined financial statements - statutory basis.

## 1. FINANCIAL STATEMENT PRESENTATION

**Introduction** – The accompanying combined financial statements – statutory basis of the Commonwealth of Massachusetts (the Commonwealth) are presented in accordance with the requirements of Section 12 of Chapter 7A, as amended by Section 4 of Chapter 88 of the Acts of 1997 of the Massachusetts General Laws. The Office of the Comptroller also publishes the Commonwealth's Comprehensive Annual Financial Report (CAFR) which is prepared on the basis of generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board, the authoritative standard-setting body for establishing governmental accounting and financial reporting principles.

The combined financial statements – statutory basis include all budgeted and non-budgeted funds and account groups of the Commonwealth, as recorded by the Office of the Comptroller in compliance with Massachusetts General Laws and in accordance with the Commonwealth's budgetary principles.

The combined financial statements – statutory basis are not intended to include independent authorities, non-appropriated funds of higher education or other organizations included in the Commonwealth's reporting entity as it would be defined under GAAP.

**Statutory Basis Accounting** – The Commonwealth reports its statutory basis financial position and results of operations in funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

Account groups are accounting entities used to provide accountability for the Commonwealth's general fixed assets and long-term obligations. They are not considered funds because they do not report expendable available financial resources and related liabilities.

The Fund types and account groups are organized as follows:

**Governmental Fund Types** - accounts for the general governmental activities of the Commonwealth.

**Budgeted Funds** – are the primary operating funds of the Commonwealth. They account for all budgeted

governmental transactions. Major budgeted funds include the General, Highway and Local Aid funds which are identified by the Comptroller as the operating funds of the Commonwealth.

**Non-Budgeted Special Revenue Funds** – are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants and the operations of the state lottery.

**Capital Projects Funds** – account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These resources are derived from proceeds of general obligation bonds and operating transfers authorized by the Legislature, which are generally received after the expenditure has been incurred, and from federal reimbursements. Deficit balances in Capital Projects Funds represent amounts to be financed.

**Fiduciary Fund Types** – account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units, and/or other funds.

**Expendable Trust Funds** – account for trusts whose principal and investment income may be expended for their designated purpose.

**Nonexpendable Trust Funds** – account for trusts whose principal cannot be spent.

**Pension Trust Funds** – account for the net assets available for plan benefits held in trust for the State Employees' and Teachers' Retirement Systems.

**Agency Funds** – account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

**Account Groups** – establish control and accountability over the Commonwealth's general fixed assets and long-term obligations.

**General Fixed Assets Account Group** – accounts for the general fixed assets of the Commonwealth.

*General Long-term Obligations Account Group* – accounts for long-term bonds and notes issued by the Commonwealth and capital leases.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Statutory Basis of Accounting** – The Statutory Basis Financial Report is prepared from the Commonwealth's books and records and other official reports which are maintained on the basis of accounting used in the preparation of the Commonwealth's legally adopted annual budget (statutory basis). The statutory basis emphasizes accountability and budgetary control of appropriations. The Statutory Basis Financial Report is not intended to present the Commonwealth's financial condition and results of operations in conformity with GAAP. Under GAAP, the books are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting.

Revenues are generally recognized when cash deposits are received by the Treasury. However, revenues receivable for federal grants and reimbursements are recognized when related expenditures are incurred. Amounts due from political subdivisions of the Commonwealth are recognized when considered measurable and available. Deeds excise taxes are recognized at the time of collection by the counties and the Commonwealth. Under GAAP, revenues are recognized when they become both measurable and available.

Expenditures are generally recorded when the related cash disbursement occurs. At year-end, payroll is accrued and payables are recognized, to the extent of approved encumbrances, for goods or services received by June 30. Costs incurred under the federally-sponsored Medicaid program, amounts required to settle claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. Under GAAP, expenditures are recorded in the period in which the related fund liability is incurred.

The Pension Trust Funds are reported using a flow of economic resources measurement focus and the accrual basis of accounting on both the Statutory and GAAP basis. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. This measurement focus emphasizes the determination of net income.

The accounting policies followed in preparing the accompanying combined financial statements – statutory basis are described as follows.

### **Cash and Short-term Investments and Investments** –

The Commonwealth follows the practice of pooling the cash and cash equivalents of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost. Interest earned on pooled cash is allocated to the General Fund, Expendable Trust Funds and to certain Special Revenue Funds when so directed by law.

The Commonwealth enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these agreements no amounts are recorded in the financial statements.

The Pension Trust Funds, with investments totaling \$22,656,891,000, at fair value, are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentration of credit risk exists if a number of companies in which the fund has invested are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 1998, the estimated fair values, determined by management with input from the investment managers, of these real estate and alternative investments were \$1,943,727,000 of the Pension Trust Funds, representing 6.7% of the total assets of the Fiduciary Fund Type.

**Securities Lending Program** - The Pension Trust Funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerage firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the fair value of the

security borrowed. At June 30, 1998, the market value of the securities on loan from the Pension Reserve Investment Trust (PRIT) was approximately \$1,190,000,000. The value of the collateral held by PRIT amounted to \$1,239,000,000 at June 30, 1998. The PRIT securities on loan were collateralized at all times by U.S. Treasury securities of at least 100% of the value.

**Receivables** – Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as “Due from federal government.”

**Due from Cities and Towns** – Represents reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

**Advances to Related Entity** – The Commonwealth periodically provides working capital advances to the Massachusetts Bay Transportation Authority (MBTA) to fund its net cost of service. These advances are repaid through subsequent appropriations by the Legislature and assessments to cities and towns for their respective shares of the MBTA’s net cost of service.

**Inventories** – The costs of materials and supplies are recorded as expenditures in Governmental Funds when purchased. Such inventories are not material in total to the financial statements and therefore are not recorded.

**General Fixed Assets** – General fixed asset acquisitions are recorded as expenditures in the acquiring fund and capitalized in the General Fixed Assets Account Group in the year purchased. General fixed assets are recorded at historical cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Improvements are capitalized.

The Commonwealth capitalizes all land except land associated with infrastructure. It capitalizes buildings and equipment, including computer software, with costs in excess of fifteen thousand dollars at the date of acquisition and with expected useful lives greater than one year. Interest incurred during construction is not material and is not capitalized. Public domain general fixed assets and infrastructure (roads, bridges, tunnels, dams, water and sewer systems, etc.) are not capitalized. No depreciation is provided on general fixed assets.

**Interfund/Intrafund Transactions** – During the course of its operations, the Commonwealth records transactions between funds and/or between departments. On the statutory basis, transactions between Governmental and Fiduciary Fund Types are recorded as adjustments to the funds’ cash accounts. As a result, a fund may report a deficiency in cash and short-term investments.

Transactions of a buyer/seller nature between departments within a fund are not eliminated.

**Risk Management** – The Commonwealth does not insure for employees workers’ compensation, casualty, theft, tort claims and other losses. Such liabilities are not recognized on the statutory basis until encumbered and/or processed for payment. For employees workers’ compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Chapter 258 of the Massachusetts General Laws (General Laws) limits the risk assumed by the Commonwealth to \$100,000 per occurrence, in most circumstances. The Group Insurance Commission administers contributory health care and other insurance programs for the Commonwealth’s employees and retirees.

The Commonwealth has entered into agreements for insurance for Central Artery/Tunnel Project workers’ compensation and certain other claims that may arise in the course of the Project. This special arrangement has been approved by the Federal Highway Administration as a cost-effective method to fund current and potential future claims by contractors, workers, and other parties affected by the project. Pursuant to the agreement, the Commonwealth conveys a sum of money to the agent each month. This amount includes both federal and state share. The agent manages and settles all claims. At the conclusion of the program, the balance remaining, if any, will be returned to the Commonwealth and the federal government. The monthly amount conveyed to the agent is accounted for (on the statutory basis of accounting) as an expenditure in the Federal Highway Capital Projects Fund.

**Encumbrances** – Encumbrance accounting is utilized in the Governmental Fund Types as a significant aspect of budgetary control. The full amounts of purchase orders, contracts and other commitments of appropriated resources are encumbered and recorded as deductions from appropriations prior to actual expenditure, ensuring that such commitments do not exceed appropriations. Encumbrances outstanding at year-end for goods or services received on or before June 30 are reported as statutory basis liabilities and expenditures.



**Fringe Benefit Cost Recovery** – The Commonwealth appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund and the Intragovernmental Service Fund. These fringe benefits include the costs of employees' health insurance, pensions, unemployment compensation, and other costs necessary to support the state work force. As directed by Chapter 29, Sections 5D and 6B(f) of the Massachusetts General Laws, these costs are assessed to other funds based on their payroll costs, net of credits for direct payments. Since these fringe benefit costs are not appropriated in the budget, the required assessment creates a variance between budget and actual expenditures at year end. The fringe benefit cost recoveries of \$224,761,000 in the budgeted funds are offset by fringe benefit costs assessments of \$155,803,000 in the governmental fund types and the expendable trust funds. In addition \$68,958,000 is assessed against the higher education non-appropriated activity which is not included in the combined financial statements - statutory basis.

**School Construction Grants** - The Commonwealth, through legislation, is committed to reimburse certain cities, towns and regional school districts for a portion of their debt service costs for school construction and renovation. These costs are recorded as expenditures when paid. The amounts expected to be liquidated with available financial resources are reported as expenditures in fund liabilities under GAAP. The long-term portion of this liability is recorded in the General Long-Term Obligation Account Group on a GAAP basis.

**Compensated Absences** – Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their then-current rate of pay. Vacation and sick leave are recorded as expenditures when paid.

**Lottery Revenue and Prizes** – Ticket revenues and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held. For certain prizes payable in installments, the Commonwealth purchases annuities and principal only and interest only treasury

strips in the Commonwealth's name, which are recorded as annuity contracts and prizes payable in the Agency Funds on a GAAP basis. The Commonwealth retains the risk related to such annuities.

**Fund Balances** – The Commonwealth reports fund balances as reserved where legally restricted for a specific future use. Otherwise, these balances are considered unreserved.

Fund balance has been reserved as follows:

“Reserved for continuing appropriations” – identifies unexpended amounts in appropriations which the Legislature has specifically authorized to be carried into the next fiscal year.

“Reserved for Commonwealth stabilization” – identifies amounts set aside in the Commonwealth Stabilization Fund according to 5C of Chapter 29.

“Reserved for tax reduction” - identifies the amount set aside in the Tax Reduction Fund according to Section 6 of Chapter 29B of the Massachusetts General Laws and amount set aside in the Tax Escrow Fund to fund the FY98 portion of permanent tax reductions authorized by Chapter 175 of the Acts of 1998.

“Reserved for debt service” – identifies amounts held by fiscal agents to fund future debt service obligations pertaining to Special Obligation Revenue Bonds authorized under Section 20 of Chapter 29 of the Massachusetts General Laws and Chapter 33, Acts of 1991 and Grant Anticipation Notes authorized by Chapter 11 of the Acts of 1997 and Chapter 121 of the Acts of 1998. .

“Reserved for employees' pension benefits” – identifies the net assets of the Commonwealth's public employee retirement systems which cannot be used for any other purpose.

“Reserved for unemployment benefits” – identifies amounts reserved for payment of unemployment compensation.

“Reserved for capital projects” - identifies amounts reserved for capital projects.

Unreserved fund balance is segregated into two components:

“Designated for specific purpose” – identifies all unreserved fund balances for which the Legislature or Executive Branch has evidenced an intention to restrict for a specific purpose.

“Undesignated” – consists of cumulative surpluses or deficits of the Governmental Fund Types not otherwise designated.

**Reclassification** – Certain reclassifications have been made to the 1997 account balances to conform to the presentation used in 1998.

### 3. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriations acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The original fiscal year 1998 appropriations act was Chapter 43, Acts of 1997. This appropriation act authorized \$17,527,458,000 in direct appropriations. In addition, the act contained \$838,636,000 in authorizations to retain and expend certain non-tax revenues of which \$820,636,000 were estimated to be collected and

expended, plus \$98,084,000 of interagency chargebacks. Chapter 43 included estimates of \$12,815,300,000 in tax revenues and approximately \$5,557,452,000 in non-tax revenues. With these revenues (exclusive of chargebacks) projected to total approximately \$18,372,752,000 and with unreserved balances of approximately \$277,831,000 carried forward from the fiscal year 1997, the budget as presented in this original appropriation act was considered to be in balance.

During fiscal year 1998, the Legislature also passed and the Governor signed, with some modification through veto, Chapters 88, 170, 221 and 226 of the Acts of 1997, and Chapters 28, 78, 99 and 156 of the Acts of 1998, which included numerous supplemental budgetary appropriations. These supplements added \$173,834,000 in direct appropriations and \$28,574,000 in additional retained revenue authorizations.

Subsequent to June 30, 1998 the Legislature passed and the Governor signed Chapters 260, 297, 299 and 319 of the Acts of 1998 which included \$293,475,000 in additional supplemental appropriations, \$62,869,000 in additional retained revenue authorizations, and \$122,000 in additional interagency chargebacks. The cumulative fiscal year 1998 appropriations, retained revenues, and interagency chargebacks totaled \$19,023,052,000. Appropriations continued from fiscal year 1997 totaled approximately \$180,260,000 and certain interfund transfers directed by statute totaled approximately \$1,574,909,000.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. In addition, certain interfund assessments to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The following table isolates this interfund activity from the budgeted sources and uses to align more clearly forecasts prepared during the budget process to the detailed fund accounting of the Commonwealth's statutory financial statements (amounts in thousands):

	Revenues and Other Financing Sources	Expenditures and Other Financing Uses
Actual as presented in the combined budget and actual statement - statutory basis.....	\$ 21,404,624	\$ 20,606,544
Adjustments to revenues and expenditures		
Municipal transit assessments.....	(155,610)	(155,610)
Transfer to the Intragovernmental Service Fund Revenues.....	(84,958)	(84,958)
Adjustments to other financing sources and uses:		
MBTA subsidy transfer.....	(129,176)	(129,176)
Fringe benefit cost assessments.....	(93,082)	(93,082)
Transfer from the Intragovernmental Service Fund to the General Fund.....	(2,861)	(2,861)
Transfer from the Revenue Maximization Fund to the General Fund.....	(60,498)	(60,498)
RMV License Plates.....	(3,169)	(3,169)
Stabilization transfers.....	(317,357)	(317,357)
Transfer to Tax Exemption Escrow Trust Fund.....	(162,500)	(162,500)
Transfer to Brownfields Revitalization Fund.....	(45,000)	(45,000)
Collective Bargaining Reserve Fund.....	(75,068)	(75,068)
Transfer to Tax Reduction Fund.....	(200,000)	(200,000)
Transfer from Tax Reduction Fund.....	(91,764)	(91,764)
Voting Equipment Loan Fund Transfer.....	(2,145)	(2,145)
Transfer from General to Children's and Senior's Health Fund.....	(36,952)	(36,952)
MWRA Debt Service Reimbursement.....	(6,720)	(6,720)
Transfer to Child Care Fund.....	(91,874)	(91,874)
Transfer to Social Services Program Fund.....	(45,937)	(45,937)
Transfer to Inland Fisheries and Game Fund.....	(104)	(104)
Transfer to Caseload Mitigation Fund.....	(10)	(10)
Actual as presented on budgetary documents.....	<u>\$19,799,839</u>	<u>\$19,001,759</u>

The following is a list of budgeted funds grouped by categories:

**Major Budgeted Funds:** General Fund, Highway Fund, Infrastructure Fund (subfund of Highway Fund) and Local Aid Fund.

**Other Budgeted Funds:** Commonwealth Stabilization Fund.

**Administrative Control Funds:** Tax Reduction Fund, Intragovernmental Service Fund, Revenue Maximization Fund, Tax Exemption Escrow Trust Fund, Collective

Bargaining Reserve Fund and Commonwealth Fiscal Recovery Fund.

**Environmental Funds:** Natural Heritage and Endangered Species Fund, Mosquito and Greenhead Fly Control Fund, Inland Fisheries and Game Fund, Environmental Challenge Fund, Toxics Use Reduction Fund, Clean Environment Fund, Environmental Permitting and Compliance Assurance Fund, Underground Storage Tank Petroleum Product Cleanup Fund, Environmental Law Enforcement Fund, Public Access Fund, Harbors and Inland Waters Maintenance Fund, Marine Fisheries Fund, Watershed Management Fund, Low Level Radioactive Waste Management Fund, Asbestos Cost Recovery Fund, Clean Air Act Compliance Fund, Solid Waste Disposal Fund, Second Century Fund and Safe Drinking Water Fund.

**Other Budgeted Special Revenue Funds:** Brownfields Revitalization Fund, Antitrust Law Enforcement Fund, Victim and Witness Assistance Fund, Intercity Bus Capital Assistance Fund, Motorcycle Safety Fund, Drug Analysis Fund, Re-Employment and Job Placement Fund, Trust Fund for the Head Injury Treatment Services, Massachusetts Tourism Fund, Health Care Access Fund, Ponkapoag Recreational Fund, Leo J. Martin Recreation Fund, Division of Insurance Fund, Health Protection Fund, State Building Management Fund, Reggie Lewis Track & Athletic Center Fund, Assisted Living Administration Fund, Commonwealth Economic Development Fund, Commonwealth Cost Relief Fund, Children's & Senior's Health Fund, Diversity Awareness Education Trust Fund, Child Care Fund, Transitional Aid to Needy Families Fund, Social Services Program Fund, Local Consumer Inspection Fund, University of Massachusetts Lowell Wannalancit Complex Building Management Fund, Caseload Increase Mitigation Fund, Boston Convention and Exhibition Center Fund and Voting Equipment Loan Fund.

The Office of the Comptroller has the responsibility to ensure that budgetary control is maintained on an individual appropriation account basis. Budgetary control is exercised through the state accounting system, Massachusetts Management Accounting and Reporting System (MMARS). Encumbrances and expenditures are not allowed to exceed the appropriation account's spending authorization.

#### 4. DEPOSITS AND INVESTMENTS

The Commonwealth maintains a cash and short-term investment pool that is available for use by all funds. Each fund type's net equity in this pool is displayed on the

combined balance sheet as either "Cash and short-term investments" or "Deficiency in cash and short-term investments." The investments of the Pension Trust Funds are held and managed in separate and pooled trusts.

The Office of the Treasurer and Receiver-General (the "Treasury") manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U.S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates fair value.

The pooled cash and short-term investments at June 30, 1998 are as follows (amounts in thousands):

	Carrying Value
Cash.....	\$ 209,792
Certificates of deposit.....	310,089
	<u>519,881</u>
Short-term investments:	
U.S. Treasury obligations.....	697
Commercial paper.....	587,752
Short-term investment pool.....	1,134,818
Repurchase agreements.....	925,000
Money market investments .....	984,088
Total.....	<u>\$ 4,152,236</u>

Pooled cash and short-term investments include the following:

Cash & short-term investments.....	\$ 6,467,535
Cash with fiscal agent.....	37,631
Deficiency in cash and short-term investments.....	(2,352,930)
Total.....	<u>\$ 4,152,236</u>

The Pension Trust Funds have invested a significant portion of their portfolios into a pooled trust which pools assets for investment purposes and allocates returns on these investments in proportion to each fund's share of the pool. The pooled trust is permitted to invest in equity securities, fixed income securities, real estate and other alternative investments.

The investments are carried at fair value. At June 30, 1998, they are as follows (amounts in thousands):

	Amount
Investments:	
Equity securities.....	\$ 11,771,083
U.S. government and government agency securities.....	3,080,784
Fixed income securities.....	2,629,537
Real estate.....	946,676
Alternative investments.....	997,052
International investments.....	3,970,468
Total.....	<u>\$ 23,395,600</u>

**Financial Instruments with Off-Balance Sheet Risk** - Certain investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. A description of such "off-balance sheet risks" are as follows:

**Forward Currency Contracts** - The Pension Trust Funds enter into forward currency contracts to hedge the exposure to change in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Fluctuations in the value of forward currency contracts are recorded as unrealized gains or losses by the Pension Trust Funds.

**Future Contracts** - The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owes or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to a percentage of the contract amount.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments which may correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its future positions due to a non-liquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The Pension Trust Funds may also invest in financial futures contracts for non-hedging purposes.

Payments are made or received by the Pension Trust Funds each day, depending on the daily fluctuations in the value of the underlying security and are recorded as unrealized gains or losses. When the contracts are closed, the Pension Trust Funds recognize a realized gain or loss.

**Options** - PRIT is also engaged in selling or “writing” options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bears the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 1998, there were no material options outstanding.

## 5. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Massachusetts General Laws authorize the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified among fund liabilities.

**General Fund** – The Commonwealth is authorized by Massachusetts General Laws to issue short-term notes to finance working capital advances to the MBTA. The Commonwealth retires these notes through subsequent appropriations and assessments to cities and towns. There were no such notes outstanding at June 30, 1998.

The balance of revenue anticipation notes (RANs) outstanding fluctuates during the fiscal year but must be reduced to zero at June 30. During fiscal year 1998, there were no RANs issued or outstanding.

**Capital Projects Funds** – The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects. During fiscal year 1998, there were no BANs issued or outstanding.

**Letter-of-Credit Agreements** – During fiscal year 1998, the Commonwealth maintained letter-of-credit agreements with several banks in order to provide credit and liquidity support for its commercial paper program. The letters of credit were available to secure up to \$400,000,000 of Commonwealth commercial paper plus interest thereon. Advances were available, subject to certain limitations and bearing interest at the bank rate as defined, in anticipation of revenue or bond proceeds and repayable by the following June 30, subject to extension in certain circumstances, at the Commonwealth’s option. No such advances were drawn during the fiscal year ended June 30, 1998, or subsequent thereto. One \$200,000,000 letter of credit agreement expired on September 1, 1998. The

remaining agreements expire on October 31, 2000. The average costs are approximately .07% on unutilized amounts and approximately .10% on utilized amounts.

**Line-of-Credit Agreement** – During fiscal year 1998, the Commonwealth maintained a line of credit with a bank to provide liquidity support for up to \$200,000,000 of commercial paper notes. The line of credit had a term through September 30, 1999 but was optionally terminated on November 4, 1997. The average cost of all the lines of credit was approximately .055% on unutilized amounts and approximately .08% on utilized amounts.

## 6. LONG-TERM DEBT

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 1998, the Commonwealth had three types of long term debt outstanding: general obligation bonds, special obligation bonds and grant anticipation notes.

The general obligation bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds,

in which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

Some Commonwealth general obligation debt is issued as college opportunity bonds (COBs) as authorized by the Massachusetts General Laws. Such bonds were issued in fiscal years 1996, 1997 and 1998 in initial amounts totaling \$64,900,000, with maturities ranging from 2000 through 2017. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the change in annual Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total \$113,900,000. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. These bonds are backed by the full faith and credit of the Commonwealth.

Chapter 48 of the Acts of 1997 abolished the former Middlesex County. As part of that legislation the Commonwealth assumed outstanding debt of the County. This debt of \$1,525,000 at June 30, 1998 is considered a general obligation of the Commonwealth.

The Commonwealth also issues special obligation revenue bonds as authorized by the Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 1998, the Commonwealth had outstanding \$606,005,000 of such special obligation bonds, secured by a pledge of 6.86 cents of the 21-cent motor fuel excise tax imposed on gasoline.

The Commonwealth also issues Federal Highway Grant Anticipation Notes (GANS) to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to \$1,500,000,000 in GANS. All Federal Highway Construction reimbursements and reimbursements from the federal highway constructions trust funds are pledged to the repayment of the GANS. Up to \$900,000,000 of said notes may be paid off through the issuance of authorized general obligation bonds of the

Commonwealth in the event federal financial assistance is not available. At June 30, 1998, the Commonwealth has \$600,000,000 of GANS outstanding with maturity dates ranging from 2005 to 2015. These notes are secured by the pledge of Federal Highway Construction reimbursements without a general obligation pledge.

During fiscal year 1991, dedicated income tax bonds were issued as authorized by Chapter 151, Acts of 1990, to finance the combined net undesignated fund deficit in the General and Local Aid Funds at June 30, 1990. These bonds were designated as Fiscal Recovery Loan Act of 1990, and they were secured by the pledge of certain dedicated income tax revenues and the investment earnings thereon, as well as the full faith and credit of the Commonwealth. These bonds were paid in full in December 1997.

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs financed. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Long-term debt outstanding (including discount and issuance cost) and debt authorized-unissued at June 30, 1998 are as follows (amounts in thousands):

Purpose	Outstanding Amounts	Maturities	Authorized - Unissued
GANS	\$ 600,000	2005-2015	\$ 919,443
Capital Projects:			
General.....	5,115,887	1998-2025	4,384,620
Highway.....	3,786,968	1998-2018	5,682,830
Local Aid.....	1,516,885	1998-2017	513,155
Other.....	58,863	1998-2025	816,690
	<u>10,478,603</u>		<u>11,397,295</u>
Total.....	<u>\$ 11,078,603</u>		<u>\$ 12,316,738</u>

Interest rates on the Commonwealth's debt outstanding at June 30, 1998 ranged from .01% to 14.1%.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 1998 are as follows (amounts in thousands):

	Bonds Outstanding	Authorized - Unissued
Balance July 1, 1997.....	\$ 10,271,294	\$ 11,954,142
General and Special obligation bonds:		
Principal less discount and issuance costs .....	870,568	(867,013)
Discount and issuance costs.....	17,393	
County Debt:		
Principal of bonds assumed.....	1,680	
Grant Anticipation Notes		
Principal less discount and issuance costs.....	580,557	(580,557)
Discount and issuance costs.....	19,443	
General obligation refunding bonds:		
Principal of bonds issued.....	647,120	
Refunded bonds.....	(626,385)	
Special Obligation refunding bonds:		
Special Obligation principal of bonds issued.....	191,080	
Special Obligation refunded bonds	(186,880)	
Increase in bonds authorized.....		2,268,342
Contributions in lieu of bonds.....		(223,157)
Bonds retired.....	(707,267)	
Expiration of authorizations.....		(235,019)
Balance June 30, 1998.....	<u>\$ 11,078,603</u>	<u>\$ 12,316,738</u>

At June 30, 1998, debt service requirements to maturity for principal (including discount, capital appreciation and issuance costs) and interest are as follows (amounts in thousands):

Fiscal year ending June 30,	Principal	Interest	Total
1999.....	\$ 658,027	\$ 534,209	\$ 1,192,236
2000.....	643,019	496,211	1,139,230
2001 .....	686,880	462,923	1,149,803
2002 .....	651,976	428,700	1,080,676
2003 .....	665,566	399,458	1,065,024
2004 and thereafter....	7,773,135	2,370,290	10,143,425
Total.....	<u>\$ 11,078,603</u>	<u>\$ 4,691,791</u>	<u>\$ 15,770,394</u>

The Commonwealth issued bonds and notes under negotiated contracts and under competitive bidding contracts during fiscal year 1998. The costs for legal counsel and underwriting fees under competitive bond

sale costs were estimated at \$102,000 and \$1,314,000, respectively. Negotiated legal fees and underwriter fees were estimated at \$501,000 and \$8,232,000 respectively. In addition, the Commonwealth paid \$70,000 for disclosure counsel services.

**Advance Refunding and Defeased Bonds** - As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general obligation bonds through the issuance of \$375,840,000 of general obligation refunding bonds during fiscal year 1998 with interest rates ranging from 4.5% to 5.8%, and \$271,280,000 general obligation refunding bonds with variable interest rates. In addition, the Commonwealth issued \$294,695,000 in special obligation bonds with interest rates ranging from 3.8% to 5.5%, which included \$191,080,000 in special obligation refunding bonds and \$103,615,000 in new issue special obligation bonds. Proceeds totaling approximately \$861,793,000, including bond premiums, were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the General Long-term Obligations Account Group. As a result of these advance refundings, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$51,400,000 over the next 20 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$35,800,000. At June 30, 1998, approximately \$813,265,000 of the bonds refunded remain outstanding and are considered defeased.

As part of its refunding activity during fiscal year 1998, the Commonwealth issued \$271,280,000 of general obligation variable rate demand bonds. The variable rate for those bonds are determined weekly based on the activity of a remarketing agent, and interest is paid monthly. In connection with issuance of the variable rate demand bonds, the Commonwealth has entered into interest rate exchange ("swap") agreements with certain counterparties. These agreements require the counterparties to pay the Commonwealth an amount equal to the variable rate payable on the bonds and in return the Commonwealth pays a fixed rate. Only the net difference in interest payments is actually exchanged with the counterparty. The bond principal is not exchanged. The Commonwealth continues to pay interest to the bondholders at the variable rate provided by the bonds.

Through these agreements the Commonwealth has effectively fixed its interest payment obligations relative to the variable rate bonds at a rate equal to 4.8%, including the costs of the liquidity facility and remarketing (The debt service requirements to maturity for these bonds presented in this note are based on that fixed rate.) The Commonwealth will be exposed to a variable rate if the counterpartys to the swap default or if the swap is terminated. A termination of the swap agreement may also result in the Commonwealth's making or receiving a termination payment.

The variable rate bonds are supported by a stand-by bond purchase liquidity facility with a commercial bank, which requires that the bank purchase any bonds that are not successfully remarketed and tendered. Until and unless remarketed, the Commonwealth would be required to pay the bank interest on such bonds at a rate equal to the bank's prime interest rate. In addition, the Commonwealth would be required to repay the principal amount of any such bonds in equal quarterly installments over the remainder of the term of the stand-by bond purchase agreement. As of June 30, 1998 the stand-by bond purchase facility has not been used. The stand-by bond purchase agreement has a stated expiration date of August 11, 2004, but may be renewed or extended by mutual consent of the Commonwealth and the bank. In connection with the agreement the Commonwealth pays a fee equal to 0.10% per year of the principal amount of variable rate bonds outstanding.

In prior years, the Commonwealth also defeased certain general obligation and other bonds by placing the proceeds of refunding bonds in irrevocable trusts to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 1998, approximately \$3,273,769,000 of bonds outstanding from advance refundings in prior fiscal years are considered defeased.

Subsequent to June 30, 1998, the Commonwealth issued \$17,683,000 in college opportunity bonds with variable interest rates and \$500,000,000 in general obligation bonds with interest rates ranging from 4.4% to 5.25%.

In addition, in September 1998, the Commonwealth issued additional variable rate refunding bonds in the amount of \$499,520,000. These bonds are structured similar to those issued in fiscal year 1998, including the use of interest rate swap agreements, obligations with respect to the bonds, and the use of a stand-by bond purchase liquidity facility with an expiration date of September 17, 2003. Through these agreements, the

Commonwealth has effectively fixed its interest payment obligations relative to the variable rate bonds at a rate equal to 4.3% including the costs of the liquidity facility and remarketing.

**Statutory Debt Limit** –The Massachusetts General Laws establish limits on the amount of direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for fiscal year 1998 was \$9,568,282,874. Outstanding debt subject to the limit at June 30, 1998 was \$9,047,467,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined to include general obligation bonds and minibonds at the amount of their original net proceeds. It excludes bond anticipation notes and discount and issuance costs, if any, financed by these bonds. It also excludes special obligation bonds, grant anticipation notes, refunded bonds, and certain refunding bonds and debt issued by counties.

The amounts excluded from the limited are as follows (amounts in thousands):

	<u>Debt Outstanding</u>
Balance June 30, 1998.....	\$ 11,078,603
Less amounts excluded:	
Discount and issuance cost.....	(702,014)
Chapter 5 of the Acts of 1992 Refunding	(144,509)
Special Obligation Principal.....	(602,531)
GANS Principal.....	(580,557)
County Debt Assumed.....	<u>(1,525)</u>
Outstanding Direct Debt.....	<u>\$ 9,047,467</u>

## 7. LEASES

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. For the fiscal year ended June 30, 1998, capital lease/purchase expenditures totaled approximately \$ 60,247,000. At June 30, 1998, the Commonwealth's aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totals approximately \$156,856,000. This liability is reported in the General Long-Term Obligations Account Group. Equipment acquired under capital leases



and included in the General Fixed Assets Account Group totaled approximately \$146,300,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature. Operating lease expenditures for the fiscal year ended June 30, 1998 was approximately \$108,412,000.

The following is a schedule of future minimum payments under non-cancelable leases as of June 30, 1998 (amounts in thousands):

Fiscal Year Ending June 30,	Capital Leases	Operating Leases
1999.....	\$ 50,650	\$ 82,030
2000.....	37,528	60,635
2001.....	27,509	44,478
2002.....	20,952	34,785
2003.....	15,541	18,162
2004 and thereafter.....	37,439	31,584
Total.....	189,619	271,674
Less interest.....	(32,763)	-
Present value .....	<u>\$ 156,856</u>	<u>\$ 271,674</u>

## 8. INDIVIDUAL FUND DEFICITS

Certain Budgeted, Non-Budgeted Special Revenue and Capital Projects Funds included in the combined totals have individual fund deficits at June 30, 1998, as follows (amounts in thousands):

Budgeted Funds:	
Local Aid Fund.....	\$ 1,939,755
Mosquito and Greenhead Fly Control Fund.....	1,301
Environmental Challenge Fund.....	4,594
Toxic Use Reduction Fund.....	1,850
Environmental Permitting and Compliance Assurance Fund.....	21,700
Environmental Law Enforcement Fund.....	1,311
Public Access Fund.....	44
Marine Fisheries Fund.....	2,739
Low-Level Radioactive Waste Management Fund.....	221
Clean Air Act Compliance Fund.....	709
Second Century Fund.....	3,367
Safe Drinking Water Fund.....	13
Anti-trust Law Enforcement Fund.....	1,771
Victim and Witness Assistance Fund.....	3,894
Intercity Bus Capital Assistance Fund.....	6,388
Health Care Access Fund.....	23,105
Ponkapoag Recreational Fund.....	30
Leo J. Martin Recreation Fund.....	156
Division of Insurance Fund.....	217
Transitional Aid to Needy Families Fund.....	35
Social Services Program Fund.....	480
	<u>2,013,680</u>

## Non-Budgeted Special Revenue:

### Other:

Government Land Bank Fund.....	34,496
	<u>34,496</u>

## Capital Projects:

Boston Convention & Exhibition Center Fund.....	19,000
Highway Fund.....	559,787
Federal Highway Construction Fund.....	34
Community Development Action Grants Fund.....	36,820
Suffolk County Jail Facility Fund.....	18
County Correctional Facility Fund.....	78
Water Pollution Control Fund.....	651
State Recreation Areas Fund.....	17
Metropolitan Parks Fund.....	3,116
Government Land Bank Fund.....	11,800
	<u>631,321</u>

Total ..... \$ 2,679,497

In order to resolve the deficits in the budgeted funds, the Comptroller has recommended the authorization of transfers from other budgeted funds with surplus balances or a plan of fund consolidation. If these changes are adopted by the legislature, the deficiencies will be resolved. For the Non-Budgeted Special Revenue Funds, the Comptroller has recommended similar budgeted transfers to subsidize and resolve the deficits or their consolidation into budgeted funds. Such steps require legislative action.

In the Capital Project Funds, the deficit of \$631,321,000 reflects the time lag between capital expenditures and the receipt or allocation of proceeds from the sale of related bonds. Subsequent to June 30, 1998, the Commonwealth issued \$17,683,000 in college opportunity bonds and \$500,000,000 in general obligation bonds to finance the deficit.

## 9. MEDICAID COSTS

The Commonwealth provides medical care for low-income, elderly and other residents who qualify for such assistance under the federally-sponsored Medical Assistance Program (Medicaid). The Commonwealth pays the full cost of care and is reimbursed by the federal government for 50% of that cost. For the fiscal year ended June 30, 1998, the General Fund, Local Aid Fund and Children's and Senior's Health Fund include \$3,665,839,000 in expenditures for Medicaid claims processed for payment.

The combined financial statements – statutory basis include Medicaid claims processed but unpaid at June 30, 1998, as accounts payable of approximately \$50,553,000. The Commonwealth estimates its total liability, as determined in accordance with generally accepted accounting principles, at \$577,553,000 including the

amounts reported as accounts payable at June 30, 1998. This amount includes estimates of both the cost of care provided as of June 30, 1998, for which claims have not been processed and other costs. Of this amount, \$271,700,000 is expected to be reimbursed by the federal government.

## 10. RETIREMENT SYSTEMS

**Primary Government** – The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth).

The members of the retirement systems do not participate in the Social Security System. The Commonwealth has also assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, in fiscal year 1997 and prior fiscal years. The Commonwealth is statutorily required to have an actuarial valuation once every three years and every two years on a GAAP basis.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis.

### Plan Descriptions –

**State Employees' Retirement System (SERS)** is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

**Teachers' Retirement System (TRS)** is an agent multiple employer defined benefit PERS with 104 participating employers. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston),

towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

**State – Boston Retirement System (SBRS)** is hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity. The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth and is not part of the reporting entity and a stand alone financial report is not available.

The policy for postretirement benefit increases for all retirees of the SERS, TRS, SBRS and COLA are subject to legislative approval.

**Membership** – Membership in SERS, TRS and SBRS as of January 1, 1998 is as follows:

	<u>SERS</u>	<u>TRS</u>	<u>SBRS</u>
Retirees and beneficiaries			
currently receiving benefits.....	43,144	30,499	2,742
Terminated employees entitled to			
benefits but not yet receiving them..	2,073	1,850	96
Subtotal.....	<u>45,217</u>	<u>32,349</u>	<u>2,838</u>
Current employees:			
Vested.....	48,035	50,477	4,181
Non-vested.....	34,596	24,422	1,269
Subtotal.....	<u>82,631</u>	<u>74,899</u>	<u>5,450</u>
Total.....	<u>127,848</u>	<u>107,248</u>	<u>8,288</u>

During fiscal year 1998, the Commonwealth abolished Franklin and Middlesex Counties, transferring their functions, assets, debts and obligations to the Commonwealth. The SERS actuarial accrued liability includes former county employees who were transferred to the Commonwealth.

**Benefit Provisions** – Massachusetts General Laws established uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group

classification. The authority for amending these provisions is with the legislature.

Retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. Average retirement benefit is approximately 80-85% pension and 15-20% annuity.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

**Funding Progress** - The SERS, TRS and SBRS actuarial determined contributions were computed as part of the

actuarial valuation as of January 1, 1998. The Commonwealth has revised three actuarial assumptions used in the calculation of contribution requirements and Unfunded Actuarial Liability (UAL). First, the assumed rate of return on investments of present and future assets was changed from 8.5% to 8.25% per year resulting in a \$641,000,000 increase in the UAL. Second, the use of an updated mortality table resulted in a \$1,100,000,000 increase in the UAL. Third, a change from using the market value of assets to an actuarial value of assets had the effect in this valuation of reporting assets at 97% of the market value. This third change results in a \$643,000,000 increase in UAL. Other significant assumptions used are (a) projected salary increases of 6% per year, (b) cost of living (inflation rate) increases of 3% per year on the first \$12,000 of the retirees total allowance, and (c) interest rate credited to the annuity savings fund of 5.5% per year. These calculations use a level dollar amortization method over 20 years closed period.

The following table presents the schedule of funding progress as presented in the five most recent actuarial valuations at the dates indicated (amounts in thousands):

Actuarial Valuation as of January 1,	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employers Retirement System						
1988**	\$ 9,914,000	\$ 11,361,000	\$ 1,447,000	87 %	\$ 3,111,000	46.5 %
1996	7,366,000	9,441,000	2,075,000	78	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68	2,992,000	91.0
1993	5,071,000	8,738,000	3,667,000	58	2,919,000	125.6
1992	4,699,000	7,303,000	2,604,000	64	2,638,000	98.7
Teachers Retirement System						
1998**	10,170,000	13,095,000	2,925,000	78	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	74	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	62	2,667,000	138.7
1993	5,142,000	8,921,000	3,779,000	58	2,428,000	155.6
1992	4,784,000	8,706,000	3,922,000	55	2,032,000	193.0
State - Boston Retirement System						
1998**	699,000	1,219,000	520,000	57	285,000	182.5
1996	549,000	1,025,000	476,000	54	274,000	173.7
1995	438,000	833,000	395,000	53	232,000	170.3
1993	370,000	743,000	373,000	50	206,000	181.1
1992	342,000	759,000	417,000	45	184,000	226.6

\* - The covered payroll amounts approximate the employer payroll.

\*\* - Revised actuarial assumptions

In addition to these system liabilities, the Commonwealth had assumed financial responsibility for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1997 and prior fiscal years. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial liability for COLA as of January 1, 1998 was \$912,029,000.

**Contributions Required and Contributions Made** – The retirement systems’ funding policies have been established by Chapter 32 of the Massachusetts General Laws. The legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and SBRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation – 5% for those hired before January 1, 1975, 7% for those hired from January 1, 1975, through December 31, 1983, and 8% for those hired on or after January 1, 1984, plus an additional 2% of compensation above \$30,000 per year for those hired on or after January 1, 1979. Regular employees and state police hired after June 30, 1996 are required to contribute 9% and 12% respectively of their regular compensation plus an additional 2% of compensation above \$30,000 per year. Costs of administering the plan are funded out of plan assets.

The Commonwealth’s contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover SBRS and COLA contributions were originally established on a “pay-as-you-go” basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in

SBRS and its COLA obligation. Chapter 32, Section 22C of General Laws enacted in 1998 calls for the payment of normal cost plus an amortization payment of UAL such that the UAL is reduced to zero by June 30, 2018.

This legislation also directs the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary’s direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule. This legislation further provides that if the pension benefits paid exceed the scheduled contribution, the Commonwealth’s contribution shall equal these benefit payments through fiscal 1997. All subsequent contributions will be made in accordance with the funding schedule.

The current legislatively approved funding schedule, based on the January 1, 1996 valuation, was adopted by the Legislature as part of the fiscal year 1998 budget process. Under the current schedule the amortization payments are designed to eliminate the unfunded liability by fiscal year 2017. It required contributions by the Commonwealth of \$1,045,570,000 during the fiscal year ended June 30, 1998. Of this amount \$127,155,000 was payments for COLA granted to participants in 104 retirement systems of cities, towns and counties.

GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost and amortization cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1,	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
<b>State Employers Retirement System</b>								
1998	\$ 261,255	\$ (83,446)	\$ 77,180	\$ 254,989	\$ 494,289	\$ 1,250,766	189 %	194 %
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
1995	249,640	(31,639)	19,614	237,615	417,361	551,973	167	176
1994	266,564	(18,448)	9,152	257,268	398,900	372,227	150	155
1993	243,587	(5,539)	2,694	240,742	402,100	230,595	165	167
1992	252,687	136	(65)	252,758	323,700	69,237	128	128
1991	282,682	2,335	(1,094)	283,923	311,400	(1,705)	110	110
1990	259,102	4,569	(2,103)	261,568	289,500	(29,182)	112	111
1989	298,800	2,160	(977)	299,983	269,866	(57,114)	90	90
1988	279,582	-	-	279,582	252,585	(26,997)	90	90
<b>Teachers Retirement System</b>								
1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
1995	277,343	(24,002)	14,880	268,221	342,441	356,601	123	128
1994	247,460	(15,975)	7,925	239,410	322,100	282,381	130	135
1993	225,838	(9,946)	4,837	220,729	296,100	199,691	131	134
1992	223,041	(4,996)	2,384	220,429	282,300	124,320	127	128
1991	249,436	(3,452)	1,617	247,601	266,900	62,449	107	108
1990	227,270	(1,459)	671	226,482	251,400	43,150	111	111
1989	249,108	(1,595)	722	248,235	246,531	18,232	99	99
1988	232,661	-	-	232,661	252,597	19,936	109	109
<b>State Boston Retirement System</b>								
1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108
1995	28,168	(1,816)	1,126	27,478	28,000	21,887	99	102
1994	22,448	(1,216)	603	21,835	28,000	21,365	125	128
1993	20,463	(650)	316	20,129	27,200	15,200	133	135
1992	26,530	(634)	303	26,199	26,400	8,129	100	101
1991	23,149	(413)	193	22,929	25,700	7,928	111	112
1990	21,118	(251)	116	20,983	23,000	5,157	109	110
1989	21,744	(127)	58	21,675	23,225	3,140	107	107
1988	20,315	-	-	20,315	21,905	1,590	108	108

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

During the year ended June 30, 1998, the Commonwealth's pension expenditure included payments totaling \$19,310,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

**Post-retirement Health Care and Life Insurance Benefits**

– In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately \$173,047,000 for the fiscal year ended June 30, 1998. There are approximately 44,600 participants eligible to receive benefits at June 30, 1998.

**11. COMMITMENTS**

Under Chapters 161A and 161B of the General Laws, the Commonwealth is obligated to provide annual subsidies to the MBTA and certain regional transit authorities for contract assistance, debt service assistance and their net cost of service deficiencies. The Commonwealth recovers a portion of these payments through assessments to the cities and towns served. During fiscal year 1998, net expenditures were \$491,133,000 and \$38,877,000, respectively. For fiscal year 1999, the Commonwealth has appropriated \$509,602,000 and \$39,212,000 to the MBTA and regional transit authorities, respectively. These appropriations cover net costs of service for the calendar year ended December 31, 1997.

The Commonwealth is also statutorily obligated to provide contract assistance for debt service obligations to the Massachusetts Convention Center Authority, the Government Land Bank and the Water Pollution Abatement Trust. Such assistance totaled \$55,382,000 in fiscal year 1998. For fiscal year 1999, appropriations for this purpose totaled \$69,779,000.

At June 30, 1998, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately \$3,485,749,000 long-term and \$401,730,000 short-term. In addition, the Commonwealth guarantees the debt of certain local governments and public higher education building authorities. The guaranteed long-term debt outstanding at June 30, 1998 was approximately \$234,069,000.

At June 30, 1998, the Commonwealth had commitments of approximately \$3,215,615,000 for various construction projects. The majority relate to construction funding for a major infrastructure project known as the Central Artery/Tunnel Project. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority and the Massachusetts Port Authority.

During fiscal year 1998, the Commonwealth received payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort) pursuant to two separate memoranda of understandings dated September 12, 1997 and August 13, 1998 respectively. The MTA and MassPort made payments to the Commonwealth to finance portion of the Central Artery/Tunnel Project Artery Tunnel Project in the amount of \$100,000,000 and \$12,115,000 respectively.

The remaining future payments are as follows:  
(Amounts in thousands)

<u>Fiscal Year</u>	<u>MTA</u>	<u>MassPort</u>
1999	\$600,000	\$30,700
2000	-	52,200
2001	-	-
2002	-	-
2003	400,000 *	105,000
2004	-	50,000
2005	-	50,000
Total	<u>\$1,000,000</u>	<u>\$287,900</u>

\* Represents contingent amount subject to the certain conditions

**12. CONTINGENCIES**

A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For those cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately \$59,200,000 which is expected to be paid in fiscal year 1999. No accrual has been made for this amount in the combined financial statements – statutory basis.

Workers' compensation costs are recognized when claims are presented and paid. The Commonwealth's outstanding liability for such claims at June 30, 1998, is estimated to be \$278,200,000, of which approximately \$35,500,000 is expected to be paid during fiscal year 1999. No accrual has been made for these amounts in the combined financial statements – statutory basis.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund which received the assistance. At June 30, 1998, the Commonwealth estimated that liabilities, if any, which may result from such audits are not material.

Chapter 200A of the Massachusetts General Laws, the Commonwealth's Abandoned Property Law, requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets, less \$4,430,000, which is expected to be reclaimed and paid in fiscal year 1999, are to be remitted to the General Fund each June 30, where it is included as miscellaneous revenue. Amounts remitted during fiscal year 1998 totaled approximately \$75,837,000. Since inception, approximately \$756,893,000 has been remitted. This represents a contingency, because claims for refunds can be made by the owners of the property.

### 13. NON-TAX REVENUE INITIATIVES

Chapter 653, Acts of 1989, amended Chapter 29 of the Massachusetts General Laws by adding Sections 29D and 29E, which authorize certain non-tax revenue initiatives and require reporting thereon, as follows.

**Debt Collection** – Private debt collectors were engaged, with fees, on a contingent basis, from the proceeds collected. Collections and fees paid during fiscal year 1998 were:

<u>Department Collectors</u>	<u>Collections</u>	<u>Fees</u>
Allen Daniel Associates.....	\$ 134,969	\$ 25,443
Collection Company of America....	486,843	104,229
Gragil Associates.....	241,105	48,206
Payco.....	46,745	9,610
Walker Associates.....	1,984,160	260,767
Windham Professionals.....	320,165	86,424
Total.....	<u>\$ 3,213,987</u>	<u>\$ 534,679</u>

Under a similar program for the Commonwealth's public institutions of higher education, the following amounts were collected and fees paid:

<u>Department Collectors</u>	<u>Collections</u>	<u>Fees</u>
Allen Daniel Associates.....	\$ 788,093	\$ 134,716
Associated Credit Services.....	7,289	1,145
Collection Company of America....	1,436,424	433,594
Financial Collection Agency.....	44,696	5,622
Glenn Associates.....	413,822	85,253
Gragil Associates.....	17,658	4,468
Payco.....	647,733	156,428
Walker Associates.....	4,726	1,021
Windham Professionals.....	644,782	127,379
Total.....	<u>\$4,005,223</u>	<u>\$ 949,626</u>

**Revenue Maximization** – Contractors were engaged on a contingent fee basis to assist several of the Commonwealth's departments in the identification and collection of federal and other revenues. During fiscal year 1998, approximately \$73,724,000 was collected through such efforts. After contractor fees of \$7,787,000 were paid on a contingent basis, the Commonwealth received approximately \$65,937,000.

Pursuant to Section 181 of Chapter 43 of the Acts of 1997 (the FY98 budget), the Comptroller's Office is authorized to engage vendors for the purpose of identification and pursuit of cost savings/avoidance opportunities. For fiscal year 1998 there was one department engaged in a Section 181 procurement/project. In fiscal year 1998, estimated total cost avoidance based on actuarial calculations was approximately \$65,257,000 and fees paid to the Public Consulting Group were \$1,786,000.

**Utility Audits** – Massachusetts General Law, Chapter 20 Section 29G, authorizes the Department of Procurement and General Services to solicit services and enter into contingent contracts on behalf of governmental entities for the potential of recoupment of overcharges associated with utility expenses. During fiscal year 1998, \$296,000 was recouped and \$148,000 was paid or payable to the Utility Management Group, resulting in a net benefit to the Commonwealth of \$148,000. As of June 30, 1998, reviews were in process for 12 municipalities who have taken advantage of the master service agreement negotiated by Procurement and General Services.

#### 14. YEAR 2000

The “year 2000 problem” is the result of shortcomings in many electronic data processing systems and other equipment that make operations beyond the year 1999 troublesome. For many years, computer programmers eliminated the first two digits from a year when writing programs. Accordingly, many programs, if not corrected, will not be able to distinguish between the year 2000 and the year 1900. These problems have the potential for causing a disruption of governmental services.

In June 1997, the Executive Office for Administration and Finance established a Year 2000 Program Management Office within its Information Technology Division. The purpose of this office is to ensure accurate monitoring of the Commonwealth’s progress in achieving “year 2000 compliance.” The program office has asked agencies to identify “mission critical” and “essential” systems. Mission critical systems are those which directly affect the health, safety or livelihood of citizens, which directly affect state revenues or whose loss would severely jeopardize agency delivery of services. Essential systems’ loss would cause disruption of some agency services but would not prevent the agency from delivering primary services.

Legislation approved by the Acting Governor on August 10, 1998 appropriates \$20,400,000 million for expenditure by the Information Technology Division to achieve year 2000 compliance for six Executive Offices and other departments, which report directly to the Governor, of this amount approximately \$4,100,000 million is committed for contracts. This amount, together with previously appropriated amounts and expenditures at the departmental level from existing funds, is anticipated by management to be sufficient to meet most of the remediation efforts for such Executive Offices and departments. The Secretary of Administration and Finance is to report quarterly to the Legislature on the progress

being made to address the year 2000 compliance efforts, and to assess the sufficiency of funding levels.

The failure of certain entities beyond the control of the Commonwealth, such as the United States government, suppliers, utility providers and financial services providers, to address Year 2000 compliance could have a material adverse impact on the operations or finances of the Commonwealth.

#### 15. SUBSEQUENT EVENTS

Subsequent to year-end, two counties were abolished and transferred to the Commonwealth and legislation was enacted which abolishes three additional counties in the future.

Section 11 of Chapter 300 of the Acts of 1998 amended Section 1 of Chapter 48 of the Acts of 1997 relative to the abolition of certain counties. The act calls for the transfer of all functions, assets, debts and obligations of the county to the Commonwealth on the transfer date. The counties of Worcester and Hampden have been transferred as of July 1, 1998 (FY99), the county of Hampshire will be transferred on January 1, 1999, (FY99); the county of Essex will be transferred July 1, 1999, (FY00); and the county of Berkshire will be transferred on July 1, 2000 (FY01).

The transfer date can be earlier if a county has failed to make a required payment on an outstanding bond or note.

The Commonwealth will include in its audited financial statements the financial activity of an abolished county in the fiscal year the actual transfers occur.





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